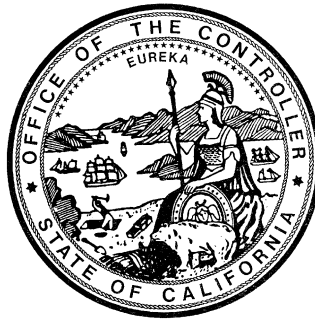


CALIFORNIA LOTTERY

Report of Analysis

QUARTERLY TRANSFER OF FUNDS TO PUBLIC EDUCATION

For the Quarter Ended June 30, 2013



JOHN CHIANG
California State Controller

February 2014



JOHN CHIANG
California State Controller

February 14, 2014

Paula D. LaBrie, Acting Director
California Lottery
700 North Tenth Street
Sacramento, California 95811

Dear Ms. LaBrie:

The State Controller's Office analyzed the financial documentation supporting the California Lottery's (Lottery) transfer of funds to the public education community for the quarter ended June 30, 2013. Our analysis found that the transfer amount of \$375,000,000 appears to be supported by the Lottery's accounting records and that the Lottery complied with the annual statutory percentages for prizes, education, and administration.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, by phone at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/sk

cc: John Smolin, Chairperson
California Lottery Commission
Gregory Ahern, Commissioner
California Lottery Commission
Nathaniel Kirtman III, Commissioner
California Lottery Commission
Connie M. Perez, Commissioner
California Lottery Commission
Nicholas Buchen, Deputy Director, Finance
California Lottery
Roberto Zavala, Chief Internal Auditor
California Lottery

Contents

Report of Analysis

Summary	1
Introduction	1
Background	1
Objectives, Scope, and Methodology	2
Results.....	2
Schedule 1—Fiscal Years 2012-13 and 2011-12 Quarter-End Lottery Revenue Allocations.....	3
Attachment—California Lottery’s Transfer Request of August 30, 2013	

Report of Analysis

Summary

In a letter dated August 30, 2013, the California Lottery (Lottery) requested that the State Controller's Office (SCO) transfer \$375,000,000 to the Lottery Education Fund for disbursement to the public education community. Our analysis found that the transfer amount appears to be supported by the Lottery's accounting records and that the Lottery complied with the annual statutory percentages for prizes, education, and administration.

On September 30, 2013, the SCO transferred \$375,000,010.54 to the Lottery Education Fund. The total amount available for distribution to the education community for the fourth quarter was \$375,000,023.73 (\$23.73 remained from prior quarter). Due to the SCO's apportionment process, all funds except \$13.10 were disbursed to the public education community. This balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

Introduction

This report presents the results of our analysis of the Lottery's quarterly request that the SCO transfer funds to the public education community. This analysis is part of our responsibility under the California State Lottery Act (Lottery Act). We performed this analysis to determine if the transfer amount to the public education community was supported by amounts recorded in the Lottery's accounting records and to determine if the Lottery complied with the annual Lottery Education Fund allocation requirements contained in the Lottery Act.

Background

In 1984, California voters passed an initiative, which by amending the State Constitution, authorized a state-operated lottery. The initiative created the Lottery Act, which requires the quarterly transfer of net revenues to the public education community and established the allocation percentages for lottery funds. The Lottery Act also requires the SCO to conduct quarterly and annual post-audits of all accounts and transactions of the California Lottery Commission and other special post-audits as the State Controller deems necessary.

The Lottery Act was amended by Assembly Bill 142 on April 8, 2010. The bill was an urgency statute that went into effect immediately. Assembly Bill 142 requires revenues from the Lottery to be allocated to maximize the amount of funding allocated to the public education community. The bill requires that not less than 87% of the total annual revenues from Lottery ticket sales be returned to the public in the form of prizes and funds to education and not more than 13% be allocated for Lottery expenses. The bill specified that not less than 50% of the total annual Lottery revenues, in an amount to be determined by the Lottery Commission, be returned to the public in the form of prizes. In addition, the bill requires the Lottery Commission to establish the percentages to be allocated to the benefit of public education.

Each quarter, the Lottery requests that the SCO transfer net revenues to the public education community (see Attachment). The Lottery's request usually occurs eight to ten weeks after the close of the quarter.

Objectives, Scope, and Methodology

We performed this analysis of the transfer of funds to the public education community for the quarter ended June 30, 2013, in order to determine if:

- The Lottery's requested transfer amount of \$375,000,000 is supported by accounting records; and
- The Lottery is in compliance with the annual allocation requirements specified in the Lottery Act.

As part of our analysis, we traced the transfer amount to the Lottery's accounting records and applied analytical review procedures to Lottery fund accounts by comparing them with those from the prior year.

Results

On September 30, 2013, the SCO transferred \$375,000,000 to the Lottery Education Fund. The total amount available for distribution to the education community for the fourth quarter was \$375,000,023.73 (\$23.73 remained from the prior quarter). Due to the SCO's apportionment process, all funds except \$13.10 were disbursed to the public education community. This balance will remain in the Lottery Education Fund to be apportioned during the next quarterly transfer.

After analyzing the Lottery's audited financial statements and supporting records for the quarter ended June 30, 2013, we determined that the Lottery's requested transfer amount of \$375,000,000 to the Lottery Education Fund appears to be supported by accounting records.

For the quarter ended June 30, 2013, of the total revenues from ticket sales:

- 59.65% was returned to the public in the form of prizes;
- 28.36% was transferred to the public education community; and
- 11.99% was used for administrative expenses.

The Lottery returned 88.01% of the total revenues from the sales of tickets to the public in the form of prizes and funds to education. The Lottery is in compliance with the annual allocation requirements specified in the Lottery Act. See Schedule 1 for a summary of Lottery transfers and allocation percentages.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

February 14, 2014

Schedule 1— Fiscal Years 2012-13 and 2011-12 Quarter-End Lottery Revenue Allocations

Fiscal Year 2012-13	Quarter Ended							
	9/30/2012	% of Sales ¹	12/31/2012	% of Sales ¹	3/31/2013	% of Sales ¹	6/30/2013	% of Sales ¹
Sales	\$ 1,008,382,162	100.00%	\$ 2,051,515,833	100.00%	\$ 3,153,730,899	100.00%	\$ 4,445,874,040	100.00%
Prizes	\$ 611,579,884	60.65%	\$ 1,245,909,894	60.73%	\$ 1,900,093,870	60.25%	\$ 2,652,095,102	59.65%
Operating income to education	\$ 277,570,269	27.53%	\$ 561,004,433	27.35%	\$ 883,957,405	28.03%	\$ 1,260,789,450	28.36%
Revenues returned to public	\$ 889,150,153	88.01%	\$ 1,806,914,327	88.08%	\$ 2,784,051,275	88.28%	\$ 3,912,884,552	88.01%
Administrative expenses	\$ 119,232,009	11.82%	\$ 244,601,506	11.92%	\$ 369,679,624	11.72%	\$ 532,989,488	11.99%
Miscellaneous income ²	\$ 10,591,621		\$ 15,064,526		\$ 19,693,087		\$ 23,581,329	
Adjustment	\$ 4,715,142 ⁴		\$ —		\$ —		\$ (5,720,287) ³	
Allocation to Education Fund ⁵	\$ 292,877,032		\$ 576,068,959		\$ 903,650,492		\$ 1,278,650,492	

Fiscal Year 2011-12	Quarter Ended							
	9/30/2011	% of Sales ¹	12/31/2011	% of Sales ¹	3/31/2012	% of Sales ¹	6/30/2012	% of Sales ¹
Sales	\$ 869,113,412	100.00%	\$ 1,971,252,588	100.00%	\$ 3,330,793,946	100.00%	\$ 4,371,491,746	100.00%
Prizes	\$ 494,773,562	56.93%	\$ 1,146,667,271	58.17%	\$ 1,936,723,462	58.15%	\$ 2,560,306,589	58.57%
Operating income to education	\$ 269,289,806	30.98%	\$ 600,187,989	30.45%	\$ 1,019,760,331	30.62%	\$ 1,298,249,204	29.70%
Revenues returned to public	\$ 764,063,368	87.91%	\$ 1,746,855,260	88.62%	\$ 2,956,483,793	88.76%	\$ 3,858,555,793	88.27%
Administrative expenses	\$ 105,050,044	12.09%	\$ 224,397,328	11.38%	\$ 374,310,153	11.24%	\$ 512,935,953	11.73%
Miscellaneous income ²	\$ 7,960,834		\$ 12,916,600		\$ 17,251,082		\$ 22,477,351	
Adjustment	\$ 4,999,206 ⁴		\$ —		\$ —		\$ (4,715,142) ³	
Allocation to Education Fund ⁵	\$ 282,249,846		\$ 613,104,589		\$ 1,037,011,413		\$ 1,316,011,413	

Annual Statutory Revenue Allocation Percentage Requirements

Prizes – Not less than 50% of sales

Administrative expenses – Not more than 13% of sales

Prizes and funds to education – Not less than 87% of sales

Other income – 100% to education

¹ Statutory compliance is determined on an annual basis at fiscal year-end. The percentages displayed in quarters 1, 2, and 3 are presented to show the Lottery's year-to-date progress towards meeting annual statutory requirements.

² Miscellaneous income includes SMIF interest earned, unclaimed prizes, and other income.

³ This amount was withheld from the fourth quarter transfer and was/will be adjusted in the subsequent quarterly transfer, pending the financial statement audit and resolution of accounting issues.

⁴ This amount was withheld from the previous quarterly transfer and was included in this quarter's transfer after the completion of the financial statement audit and resolution of accounting issues.

⁵ The Education Fund allocation amount is sales plus miscellaneous income, plus/less the adjustment amount, less prizes, and less administrative expenses.

**Attachment—
California Lottery's
Transfer Request of August 30, 2013**

700 North Tenth Street
Sacramento, CA 95811
calottery.com



August 30, 2013

Mr. George Lolas, Chief
Division of Accounting and Reporting
State Controller's Office
3301 C Street, Suite 700
Sacramento, CA 95816

Dear Mr. Lolas:

The California State Lottery requests that you transfer to the Lottery Education Fund for disbursement to the education community \$375,000,000. This figure represents:

Operating income for the year ended	
June 30, 2013	\$ 1,260,789,450
SMIF interest earned	1,220,691
Other income	47,879
Unclaimed prizes	<u>22,312,759</u>
	\$ 1,284,370,779
 Less: Transfer for the nine months ended	
March 31, 2013	\$ 903,650,492
 Amount withheld pending audit	<u>5,720,287</u>
	<u>\$ 375,000,000</u>

We have attached a copy of the Statement of Revenues, Expenses, and Changes in Net Assets for the year ended June 30, 2013, prepared from books without audit, for your files.

Sincerely,

Nicholas Buchen, Deputy Director
Finance Division

Attachment
cc: Paula LaBrie, Acting Director

CALIFORNIA STATE LOTTERY FUNDStatement of Revenues, Expenses, and Changes in Net Assets
For the Twelve Months Ending June 30, 2013

Lottery sales	\$4,445,874,040
Prizes	2,652,095,102

Sales after prizes	\$1,793,778,938

Less game costs:	
Retailer costs	\$302,946,127
On-line game costs	49,562,417
Off-line game costs	27,588,889

Total game costs	\$380,097,433

Income before operating expenses	\$1,413,681,505

Operating expenses:	
Salaries, wages and benefits	\$56,781,125
Advertising	56,044,193
Promotion, public relations and point of sale	7,854,549
Other professional services	12,651,314
Depreciation and amortization	5,980,272
Other general and administrative expenses	13,580,602

Total operating expenses	\$152,892,055

Operating income	\$1,260,789,450
Non-operating (expenses) revenues:	
Investment earnings	(\$52,309,163)
Other Income	47,879
Allocation to Education Fund	(1,262,058,020)

Total non-operating (expenses) revenues	(\$1,314,319,304)

Changes in net assets	(\$53,529,854)
Total net assets-beginning of year	155,597,555

Total net assets-end of year	\$102,067,701
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**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>